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Supreme Court of the United States

No. 354

CAROLINE R. KUEHNER AND FREDERICK G. FISCHER, as Trustees,

Petitioners,

against

GRAYSON M.-P. MURPHY, *et al.*, as a Preferred Stockholders' Protective Committee, *et al.*,

Respondents.

IRVING TRUST COMPANY, as Trustee of the estate of United Cigar Stores Company of America, Debtor,

Respondent.

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT TRUSTEE

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Of Counsel.

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Supreme Court of the United States

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as Trustees,
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IRVING TRUST COMPANY, as Trustee of the estate of United Cigar Stores Company of America, Debtor,
Respondent.

No. 354

ON WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF THE REORGANIZATION TRUSTEE

The Opinions of the Courts Below

The opinion of the Circuit Court of Appeals is reported in 85 F. [2d] 35; the memorandum opinion of the District Court is unreported, but appears at R. 146; and the report of the Special Master appears at R. 79.

Statement of the Case

This is a petition by landlords, who have been allowed a claim in proceedings under § 77B of the Bankruptcy Act

for $44,377.55, being an amount equal to three years' rent (plus accruals of unpaid rent)[1] from the date of the landlords' re-entry following the Debtor's bankruptcy in 1932.

The landlords appeal from that part of the order which limited their claim to three years' rent, and which rejected their contention that the balance is allowable in subordination to other provable claims but in priority to the interests of the stockholders of the Debtor (R. 122).

Questions Presented

The Reorganization Trustee, which commenced this proceeding by moving to have the claim limited to an amount equal to three years' rent, files this brief in support of the order below granting such motion. The questions considered in this brief are therefore

(a) whether by the three-year provision in Section 77B (b) of the Bankruptcy Act Congress intended to limit landlords' claims as against stockholders and not simply their parity status with other creditors;

(b) if so, whether such a statutory limitation is a constitutional exercise of the bankruptcy power of Congress.

Statement of Facts

In October, 1926, the petitioners' predecessors made a lease to the Debtor of a building and store property in the

[1]This refers to accruals up to the date of re-entry, from which date the three-year period runs. As these accruals were allowed in this case, and (in our judgment) properly so, no further reference to this feature will be made in this brief.

business center of the City of Trenton, New Jersey (R. 30-32). The term was to run until March 31, 1946, at a net annual rental of $10,500 for the first ten years and of $11,500 thereafter (R. 46-47). The Debtor was adjudicated bankrupt on August 29, 1932, and its Trustee in Bankruptcy rejected the lease and surrendered the premises on November 14, 1932 (R. 5-6). The petitioners promptly reentered, thus terminating the lease according to its provisions (R. 57-58), and thereafter relet portions of the property from month to month or for short terms to other tenants (R. 41).

The Debtor had covenanted in the lease that in case of such termination

> "it will indemnify the Landlords against all loss of rent which the Landlords may incur by reason of such termination, during the residue of the term above specified" (R. 58).

After § 77B had been enacted and these proceedings begun, the petitioners filed a claim for the entire rent payable under the lease until its expiration in 1946, less the alleged fair rental value for the same period (R. 4-11). The Trustee objected to the claim as filed and moved to reduce it to an amount limited as provided by the statute (R. 12-17). The District Court and the Circuit Court sustained the objection and allowed the claim on such limited basis, *i.e.* $44,377.55.[2]

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[2]This figure exceeds the amount claimed in respect of three years' rent and accruals ($43,074.19, R. 10), but, pursuant to the Special Master's report (R. 93), is accepted by the parties as the proper computation of the claim.

Statute Involved

The controversy calls for a construction of the following portion of § 77B(b) of the Bankruptcy Act dealing with landlords' claims:

> "*The claim of a landlord* for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this act, but *shall be limited* to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after the filing of the petition, plus unpaid rent accrued up to such date of surrender or reentry: * * *." [Italics ours.]

Summary of Argument

I. The statute is unambiguous in its limitation of landlords' claims to three years' rent.

II. Resort to legislative history only confirms that it was the purpose of Congress so to limit landlords' claims.

III. The suggestion that, upon submission of the Plan of Reorganization, there should be proceedings for allowance as against stockholders of landlords' claims in excess of three years' rental, would defeat the purpose of the Reorganization Statute.

IV. The statute comes within the scope of the bankruptcy power. *Louisville Joint Stock Bank* v. *Radford,* 295 U. S. 555.

V. The statute represents a reasonable exercise of the bankruptcy power. The problem being to provide for an equitable distribution of the assets of the estate (*Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, 227), Congress is not limited in its choice of means to adopting the common law method of computation of damages in similar cases. Reasonable bases are readily apparent to support the principle of a statutory maximum as a means of providing a fair settlement to contingent creditors.

ARGUMENT

POINT I.

THE STATUTE IS UNAMBIGUOUS IN ITS LIMITATION OF LANDLORDS' CLAIMS TO THREE YEARS' RENT.

In the absence of ambiguity, there is no room for statutory construction. *St. Louis & Iron Mountain Ry.* v. *Taylor,* 210 U. S. 281, 294, 295; *United States* v. *Hill,* 248 U. S. 420, 424; *Adams Express Company* v. *Kentucky,* 238 U. S. 190, 199.

This statute is "plain on its face", *Asiatic Petroleum Co.* v. *Insular Collector,* 297 U. S. 666. It first describes the claim and then says that the claim "SHALL BE LIMITED to" three years' rent. There is no condition, exception or limitation.

And there is no hint or suggestion that there is to be a distinction between the amount for which the claim shall be provable on a parity with § 63(a) claims, on the one hand, and an amount provable in subordination thereto but superior to the rights of stockholders, on the other hand. The provision is simply that "The claim" * * * "shall be treated as a claim ranking on a parity with debts which would be provable under § 63(a) of this act," but "shall be limited" to an amount equal to three years' rent, etc.

POINT II.

RESORT TO LEGISLATIVE HISTORY ONLY CONFIRMS THAT IT WAS THE PURPOSE OF CONGRESS SO TO LIMIT LANDLORDS' CLAIMS.

If it were proper to resort to legislative history as an aid to construction of a statute so plain on its face, that history (as described in the petitioners' brief) would itself be decisive and in our favor. It shows that the bill before Congress first provided for the very distinction (between parity claims and subordinated claims) contended for by the petitioners, and then that Congress deliberately obliterated the distinction by amendment (*Wood* v. *Broom,* 287 U. S. 1, 7-8). It even shows the compensation for the amendment, as the bill first provided only for one year's rent on a parity, and the balance subordinated (H. R. 5884; May 7, 1934, p. 11); whereas the amendment struck out the latter provision, and raised the former to three years (H. R. 1821; May 29, 1934, p. 2).

In other words, the bill first provided that such claims should be provable on a parity with §63 (a) claims, up to the same amount for which rent claims were by the same

statute[3] made provable under §63 (a) (viz., 1 year), and that the balance of the claim should be subordinated to provable claims but preferred over stockholders. But Congress evidently then determined that such provision would call for unduly complicated proceedings, out of harmony with the purpose of § 77B to obtain a summary and speedy reorganization. *Continental Illinois Nat. Bank & T. Co.* v. *Chicago, Rock Island & Pacific Ry. Co.*, 294 U. S. 648, 685. It turned, therefore, to a practical, yet equitable, disposition of the matter, by making the entire amount of such a claim provable *as* a claim, and subject to a maximum amount, which it then raised to three years' rent.

POINT III.

THE SUGGESTION THAT, UPON SUBMISSION OF THE PLAN OF REORGANIZATION, THERE SHOULD BE PROCEEDINGS FOR ALLOWANCE AS AGAINST STOCKHOLDERS OF LANDLORDS' CLAIMS IN EXCESS OF THREE YEARS' RENTAL, WOULD DEFEAT THE PURPOSE OF THE REORGANIZATION STATUTE.

The petitioners suggest that, if their interpretation of the statutory provision in respect of the excess of their claim over the amount of three years' rent be accepted, there must be a hearing and determination as to the treatment to be accorded such excess at the time of submission of a plan of reorganization. A similar suggestion was adopted by the Special Master (R. 88) and is now urged upon this Court by the brief *amicus curiae* filed on behalf

[3]Act of June 7, 1934, §4 (7), as amended June 18, 1934, amending §63 (a) of the Bankruptcy Act, 11 U. S. C. 103 (a) (7).

of Jacob Ruppert Realty Corporation, an intervenor in the reorganization proceedings of the Debtor.

Any such suggestion, if adopted, would, it seems to us, utterly defeat one of the prime purposes of Section 77B. Under that statute, an expeditious reorganization is the end to be attained. But, if the landlords' claims for future rent (and these constitute the great bulk of the litigated claims in this estate) are not to be fully determined until the time of hearings on the plan, confirmation of the plan may have to be deferred for a long period thereafter. This is because a landlord claimant or an objector would be entitled as of right to carry any question as to the treatment of the excess claim from the Special Master to the District Court, and in turn, to the Circuit Court of Appeals, and (as in the present case) might well be granted a review by this Court on writ of certiorari. The present case provides an example of the time-consuming effect of such a procedure, as it has been handled most expeditiously, and yet the argument in this Court will be nearly one year and a half after the initial hearing before the Special Master (R. 18).

And we can find no support in the statute for this theory. There is no distinction made anywhere in the statute between claims *allowable* for the purpose of fixing the rights of creditors, and claims *allowable* for the purpose of determining the interests of stockholders. The statutory scheme is to determine the relative rights and priorities of creditors and stockholders alike, in a single proceeding or set of proceedings, and then to base an appropriate plan of reorganization on the results of that determination.

We conclude, therefore, that the important question in the case is the constitutional one,—whether Congress has the power, as against the Fifth Amendment, to provide for allowability of contingent landlords' claims and then to impose a maximum limit on the amount for which they may be allowed.

POINT IV.

THE STATUTE COMES WITHIN THE SCOPE OF THE BANKRUPTCY POWER.

As this Court pointed out in *Louisville Joint Stock Land Bank* v. *Radford,* 295 U. S. 555, the historic purpose of bankruptcy legislation has been the discharge of personal obligations of the bankrupt.

The decision in the *Radford* case was evidently put upon the ground that, as against the Fifth Amendment, Congress could not, under the bankruptcy power, take away a vested right in specific real estate (in that case mortgage rights). This Court was careful to point out that the contrary rule applied where only a personal obligation was concerned, and that in such a case the Congress (being free of constitutional inhibition upon impairment of contracts) had the power to limit or destroy personal obligations. See the opinion, 295 U. S. at page 589:

> "Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the States, it is not prohibited from impairing the obligation of contracts."

This distinction between secured debts (representing vested rights in specific property) and unsecured debts

(personal obligations), and consequently between the power of Congress (which may discharge the latter, but not the former) and the power of the states (which may discharge neither), has long been recognized. In the leading case of *Hanover National Bank* v. *Moyses,* 186 U. S. 181, 188, Mr. Chief Justice Fuller thus expressed the same distinction:

> "The subject of 'bankruptcies' includes the power to discharge the debtor from his contracts and legal liabilities, as well as to distribute his property. The grant to Congress involves the power to impair the obligation of contracts, and this the States were forbidden to do.
>
> "The laws passed on the subject must, however, be uniform throughout the United States, but that uniformity is geographical and not personal, and we do not think that the provision of the act of 1898 as to exemptions is incompatible with the rule."

Accord: *Stellwagen* v. *Clum,* 245 U. S. 605, 613: the test of uniformity is "geographical and not personal."

The statute here under consideration does not have for its purpose the abridgement of creditors' rights in specific property, but it deals solely with the discharge of the personal obligations of the Debtor. Thus, the statute comes clearly within the scope of previous bankruptcy acts and does not transcend the bankruptcy power of Congress.

POINT V.

THE STATUTE REPRESENTS A REASONABLE EXERCISE OF THE BANKRUPTCY POWER.

There is no conflict between the circuits on the constitutionality of the statutory limitation. As far as we

know, it has been considered only in the second and fourth circuits, viz., in this case and in the case of *Campbell* v. *Alleghany Corporation*, 75 F. [2d] 947, at page 951, cert. den. 296 U. S. 581. In the latter case, the constitutionality of the provision was assumed. It is our position that these decisions are consistent with the fundamental test applied by this Court in such cases, viz., the test whether a statute represents *a reasonable exercise* of one of the recognized Congressional powers.

(A).

Principles Applicable.

It is settled that it is within the scope of the bankruptcy power for the Congress to provide for an *equitable distribution* of the assets of the estate, *Kothe* v. *R. C. Taylor Trust*, 280 U. S. 224, 227.

Congress is not shorn of judgment in the matter, and left simply to the judicial task of reading and applying the respective State laws.[4] If that were the full scope and extent of the congressional power, the word "equitable" would be without meaning.

The suggestion by the petitioners in this case comes to this: That any effort by Congress itself to legislate as to the adjustment of claims is unconstitutional, the argument being that the Constitution requires each claim to be passed upon judicially, and with a single eye to the determination

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[4]Indeed, in so far as the issue is one of power alone, the determination of Congress may well be absolute, even to the point of excluding such claims altogether from the statutory scheme of distribution (*Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 332).

of the extent to which it would or would not be recoverable under State or common law.

A fallacy in the petitioners' argument is that it starts with the assumption that the landlord's "injury" under the statute is necessarily represented by the difference between (*i*) the rent reserved and (*ii*) present rental value, *i.e.*, the rent that would be agreed upon for the balance of the term if the landlord were forced to contract for the entire balance of the term at the time of the bankruptcy.

But when leases are terminated for default after bankruptcy, landlords are not necessarily compelled forthwith to contract for the entire balance of the term. It is common knowledge that bankruptcies of companies subject to leasehold obligations normally occur in times of depression when markets are demoralized and rents are low. It would be poor business for landlords with bankrupt tenants, particularly those having long term leases, to contract at such a time for the entire remaining term of the lease; and it would be a rigorous law that would require all creditors and stockholders to submit to an inflexible rule that the landlords' injuries are to be measured on that basis.

It is common knowledge that the future is unknown and that the speculative character of prophecy increases rapidly as the span of time becomes longer.

It is equally common knowledge that cycles of depression have been consistently followed by cycles of rising prices and values,—not least, of rental values. The petitioners' argument is, in its effect, that Congress must ignore this fact, of which all have knowledge; that it is beyond the constitutional power of Congress to take account of the prospect that periods of depressed values, carrying with them depressed rents and bankruptcies, will be succeeded by periods of rising values and rising rents.

The petitioners state that they base their argument on *Filene's Sons* v. *Weed,* 245 U. S. 597, and *Irving Trust Company* v. *Perry,* 293 U. S. 307, which recognized that, where two private parties had contracted that recovery should be measured by the difference between rent reserved and present rental value, the contract is fair.[5] They develop their argument just as they would have done if Congress had enacted a statute that all landlords' contracts should be liquidated in bankruptcy upon the same basis as the contracts considered in the *Filene* and *Perry* cases. But this was not the statute enacted.

And there is certainly no constitutional requirement that the statute that was enacted should be so construed. It is absurd to say, and unsound to assume, that when this Court has approved a contract as fair (*i.e.,* as not amounting to a penalty, compare *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224), thereafter Congress is precluded, when legislating on

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[5]Although the petitioners suggest that the formula which they advocate is the accepted, if not the required, method of judicially determining landlords' claims, many of the cases which they cite (or refer to as having been cited in the *Filene* case) for this proposition, do not support it. Some of the cases were not decided until after the term of the lease had expired or there had been a reletting for the balance of the term, so that there was no longer any uncertainty either as to the event or as to the amount of the loss sustained by the landlord, *McGraw* v. *Union Trust Co.,* 135 Mich. 109; *Smith* v. *Goodman,* 139 Ill. 75; *Woodman* v. *Wise,* 112 Md. 35; *People* v. *St. Nicholas Bank,* 151 N. Y. 592. In other of the cases the landlord was denied any recovery at all for future rent, *Ex parte Blake,* 11 Ch. Div. 572; *Woodbury* v. *Sparrell Print,* 197 Mass. 426; *International Trust Co.* v. *Weeks,* 203 U. S. 364; *Bowditch* v. *Raymond,* 146 Mass. 109. And in still others, while the courts did arbitrarily award the landlords flat sums as approximating the future deficiency, the exact method of computation is not disclosed, *Leo* v. *Pearce Stores Co.,* 54 F. (2d) 92, 57 F. (2d) 340; *In re Carruthers,* 15 Rep. 317; *In re Reading Iron Works,* 150 Pa. St. 369.

the same subject, from adopting any other fair provision. Indeed, there can be no question but that, once having recognized as fair the formula for computing damage in the *Filene* case, this Court would likewise have approved a further provision in such formula limiting the damage in any event to say three years' rental.

Moreover, in this case, the petitioners do not even have the type of contract that was present in the *Filene* and *Perry* cases. The provision therein considered (known as the "*ipso facto* clause") was one that has been used in leases looking to protection of the landlord in the event of his tenant's bankruptcy. But more familiar is the entirely different type of clause known as the "indemnity clause", of which the present lease provides an example (R. 58).[6]

The untenability of the petitioners' position is neatly shown by the following sentence in their brief (at p. 15):

> "Nor does the use of the formula [the *Perry* case formula] involve an attempt to forecast the amount of rent the Landlord will lose over the remainder of the term."

But the petitioners' claim is based upon a covenant that the tenant

> "will indemnify the Landlords against all loss of rent which the Landlords may incur by reason of such termination, during the residue of the term" (R. 58).

Therefore, the very thing that the formula, upon which the petitioners rely, does *not* attempt to accomplish, is the only thing to which the petitioners' covenant entitles them.

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[6]The two types of clause were recognized in the opinion in *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 337-338.

The distinguishing characteristic of the *"ipso facto* clause" is that it first presumes, for the purpose of creating a formula for liquidating damages, that rental values at the time of bankruptcy will remain the same over the term of the lease, and then makes that presumption irrebuttable. Quite different is the "indemnity clause" which, instead of applying a formula based on a mere presumption, provides that the landlord shall have no more and no less than actual *indemnity* over the full term of the lease.

The one forecasts the loss over the long term and irrevocably assumes that future value will be the same as present value. The other refrains from making any forecast at all and awaits the end of the term in order that it may make an accurate determination based on actual experience, *Hermitage* v. *Levine,* 248 N. Y. 333.

Neither provision is perfect. The one is over-bold because it closes its eyes to the prospects of future changes (which over the period of a long term lease are certain to occur); the other is unduly timid, because it awaits certainty, and recognizing that a present forecast involves some element of speculation, refuses to make any forecasts at all.

And neither clause meets the peculiar problem of a reorganization proceeding. That calls for a speedy determination or liquidation of all claims. On the other hand, speed is not to be attained either by sacrificing contingent creditors to the other creditors or by sacrificing the other creditors to contingent creditors. Thus, individual holders of contingent claims are not to be ruthlessly eliminated (as was often done under the old bankruptcy practice), nor, on the other hand, are their claims to be hastily and negligently allowed at excessive levels.

The clause that Congress enacted was accordingly one which would provide compensation for the "injury" to the contingent, as well as to the ordinary, creditor, but which placed some limitation on the degree to which that "injury" could be speculatively forecast and measured.

Our problem is not, therefore, whether the Congressional provision is like the clause in the *Filene* lease, or like the "indemnity clause" in the present lease. It is like neither. Our problem is rather whether the Congressional provision is reasonable in itself, or is arbitrary and capricious.

Before passing to that question, we should point out that the Court is not called upon here to consider whether a claimant with an *"ipso facto* clause" (such as was present in the *Filene* and *Perry* cases) would be entitled to the full benefit of that clause or would be confined by the three year limitation. It may be that such a clause, because it gives rise immediately upon bankruptcy to an independent personal covenant apart from the real estate provisions of the lease, *cf. Irving Trust Co.* v. *Perry,* 293 U. S. 307, 311, would not be subject to the three year limitation. But the same thing is by no means true of the "indemnity clause".

Indeed it was argued below by the debenture holders' and preferred stockholders' committees that the effect of the "indemnity clause" is to deprive the landlord of any present recovery at all, and at the least to postpone him to a recovery against the reorganized company at the end of the term, when his claim would be allowable on common law principles. But a disposition of the latter character, although giving to the claimant landlord no less than his contract calls for, would be a serious handicap to any reorganization. With leases running (like this one) to 1946, others

running for 99 years, and others for terms of varying duration, the reorganized company would be assuming recurrent, but uncertain, commitments. It might be that rental values would rise sufficiently over the 14 year period or the 99 year period to immunize the reorganized company from any obligation on indemnity covenants. It might be that rents would so decline as to render those obligations absolutely crippling. It makes no difference which; the governing point is that either possibility clouds the future of the reorganized company with uncertainty.

The Congress therefore, in providing for a present recognition of claims of this character, was not recognizing an existing contractual right (as might be the case with a *Filene* or a *Perry* type claim), but was by statute giving to landlords a claim on which otherwise they might never realize, and on which they certainly could not realize for many years.

Petitioners' argument, in referring to the analogy of equity reorganizations (*cf. Northern Pacific Railroad Company* v. *Boyd,* 228 U. S. 482, and *Howard* v. *Maxwell Motor Company,* 269 Fed. 292, 275 Fed. 53), overlooks the fact that, under those cases, when read together with the rule in *Hermitage* v. *Levine,* 248 N. Y. 333, no claim would arise to the petitioners until 1946. Accordingly, the petitioners omit to mention that § 77B gives them a new remedy of substantial tangible value, in that it gives them an immediate claim in lieu of one that would otherwise have been deferred for 14 years and might then not exist at all.

But, if we are to assume for the purpose of the argument that *present* rental value must be accepted as the only practicable base of determination of *future* damages, *i.e.,* if we must reject the suggestion which has been inherent

in our argument to date (to wit, that testimony could well be taken as to future probabilities in rental value), still this method of approach remains necessarily uncertain, and the longer the future term, the greater the uncertainty.

The ultimate question is always as to what the loss will be in the future. That is the real "injury". But that cannot be scientifically answered by determining what the loss would be only on the present basis.

However, if prophecies as to the future are, on practical grounds, to be eliminated from evidence, and only the present may be testified to, then it is obviously not improper to provide for an adjustment or correction of the present valuation so as to discount (as it were) changes probable in the future. If it is probable that the future values will exceed present values, then present estimates should be reduced. If it is probable that the future values shall be less than the present values, then present estimates should be increased.

As we have pointed out, the normal situation in the case of a tenant's bankruptcy is that it occurs during a period of depression, and consequently when it is probable that rentals in the future will increase. Accordingly, Congress takes an appropriate method of correcting the present estimate to adjust for future probability, when it places a maximum limitation upon the present estimate of loss.

We now revert to the question whether, taking all of these factors into consideration, Congress was constitutionally entitled, when it determined to permit such claims to be allowed, to place a maximum upon the amount for which they might be allowed.

Judicial decisions on the subject of the application of the bankruptcy law to leases prior to the adoption of § 77B

recognized the two elements of uncertainty,—uncertainty as to whether there would be any loss at all, and uncertainty as to the amount of that loss (if any). See *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 331; *In re Metropolitan Chain Stores* (*First National Bank* v. *Irving Trust Co.*), 66 F. [2d] 485, 487 (C. C. A. 2); *cf. Wolf* v. *Stix*, 99 U. S. 1, 8.

The petitioners argue that Congress may constitutionally legislate on the subject of the first contingency, but not of the second. They say that Congress may provide for a future loss, notwithstanding that the courts have long recognized that it is uncertain whether there will be any loss, but that Congress may not provide for some recognition of the uncertainty as to the amount of such loss, notwithstanding that the courts have long recognized that uncertainty also. The argument places the courts in this paradoxical position,—that, notwithstanding that they themselves have heretofore been free to recognize both uncertainties, they are now asked to prohibit to Congress the right to recognize either.

But, it is suggested, the limitation here placed by Congress on the amount of provable future loss is arbitrary, because it is based on a fixed number of years of full rent. An elaborate table is submitted (petitioners' brief, p. 41) to indicate that an allowance *equal to* three years' rent would have a different practical effect in different cases. But this is without significance, for the three years is not to be the amount provable but is to be the *maximum* amount provable. Congress did not say that the various hypothetical landlords, imagined in the petitioners' brief, *should* each receive the equivalent of three years' rent. Some might receive the equivalent of two years' rent, some of one, some of six months, some of three months, and an

occasional one might receive, as do the petitioners, the equivalent of three full years' rent. But certainly all are not to receive the maximum.[7]

In seeking the Congressional intention, as we are now doing, the established rule is that we must recognize its constitutional validity if there be any reasonable ground to support it.

What then are the reasonable grounds upon which Congress may have acted?

First and foremost, Congress doubtless took account of what is really a certainty, viz, that the future is unpredictable. As expressed by Judge Learned Hand for the Circuit Court of Appeals

> "The appraisal of realty at a distant time is the merest guess; nobody can possibly know anything about it, and one man's guess is nearly as good as another's. For this reason Congress might circumscribe its use to the near future, not only as against creditors, but as against the lessee itself." (R. 153.)

Further reasonable grounds for the Congressional view are easily discernible. Congress may have felt that 50% was a reasonable maximum recognizable decline in rents during a depression, and that six years was a reasonable maximum period of time to forecast the continuance of a depression. Or it may have felt that 75% was a reasonable maximum recognizable decline in rents during a depression,

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[7]But, it may be said, if Congress could impose a maximum, should it not also be required to impose a minimum (as, that all landlords' claims shall be allowed for at least one year's rent)? The answer is obvious: that a landlord may, for example, have relet for the full or a higher rental to a fully solvent tenant.

and that four years was a reasonable maximum period of time to forecast the continuance of a depression. Either forecast would lead to the provision as enacted.

Each forecast, and others of the same character that may be imagined, would be based on the twin principles already enumerated, *first,* that landlords will probably lose something, *second,* that they will probably not lose over a long-term lease as much as they would lose if rental values were to remain at depression levels.

The principle of a statutory maximum[8] is, therefore, in fact based on the forecast that depressions will end and values will rise. But (it may be said) this is not certain. We agree; yet Congress is not confined in its reasoning to reliance upon certainties. It may weigh possibilities, and certainly may base its legislation upon probabilities.

What then is the extent of the probability of which Congress has taken account? It is a probability of the strongest character in the field of economics, in that it is a probability which will become a certainty *unless* the whole course of our economic history be reversed, as must be the case if the series of economic cycles be replaced by permanently low levels.

But surely neither the landlord nor any other citizen has a constitutionally vested right in an assumption that depressions will be permanent.

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[8]The principle of legislative fixing of maximum periods of time is, of course, well-established in the Bankruptcy Act, e. g. the four months' limitation for setting aside preferences, and the six months' limitation for proving claims. Each of these provisions is binding, notwithstanding that the mere chance of an event's falling within a rigidly predetermined period of time may cut off entirely a claimant's right in a given case.

(B)

APPLICABLE AUTHORITIES IN THIS COURT AND THE LOWER FEDERAL COURTS.

This Court has firmly established the principle under which the broad powers of Congress can be respected and enforced, without running to arbitrary or absurd results.

So here, the Congress has made a decision that three years' rental provides a reasonable maximum degree of limitation on the provability of this inherently contingent and speculative type of claim. That decision is not arbitrary or capricious. It is not devoid of a reasonable relationship to the legitimate end of providing for equitable distribution under the Bankruptcy Act (*Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, 227). On the contrary, it represents an effort to make a reasonable appraisal of that factor of uncertainty which, according to the earlier decisions under the Bankruptcy Act, had appeared to the courts to be of absolutely decisive importance against Landlords' claims.

Heiner v. *Donnan,* 285 U. S. 312, relied on by the petitioners, is an example of the invalidation of a statute because "arbitrary and capricious". The last words appear repeatedly in the opinion, 285 U. S. at pp. 326, 330, 332. The holding of the Court was that a tax statute was invalid which attempted to establish an irrebuttable presumption that a gift within two years of death was made in contemplation of death. The Court's view is illustrated by the following, 285 U. S. at p. 327:

> "The presumption here excludes consideration of every fact and circumstance tending to show the

> real motive of the donor. The young man in abounding health, bereft of life by a stroke of lightning within two years after making a gift, is conclusively presumed to have acted under the inducement of the thought of death, equally with the old and ailing who already stands in the shadow of the inevitable end. * * *"

The mere determination of the amount of time prior to death could in *itself* have no possible relation to the question as to the intent of the donor at the time.

The problem of Congress under §77B was to make an equitable disposition of landlords' claims not previously provable. This Court had called attention to the fact that as a practical matter the landlord was wiped out under the existing law; it had recognized (in the *Manhattan Properties* case, 291 U. S. at pp. 331-332) the landlords' argument of

> "unfairness to the landlord of a corporate bankrupt who, under the decision below, cannot prove upon his lease along with other creditors, but must look solely for redress for loss of future rents to a corporate debtor whom bankruptcy has stripped of all assets."

The problem of Congress was, therefore, to award something to him who had nothing before.

In determining upon such treatment for landlords as a a class, Congress could not fail to take into account the inherently speculative and contingent character of claims for loss of future rents, as recognized by the long line of federal cases denying provability to such claims under Section 63a of the Bankruptcy Act prior to its amendment in 1934. *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 335. To allow proof beyond the three-year

maximum would thrust the determination of damages far beyond the bounds of normal forecasting of real estate value and into the realms of conjecture and guess-work. It was this consideration that was uppermost in the mind of the District Judge, when he referred to the limitation as being "intended to put at rest the interminable speculative considerations that had to be taken into account in arriving at damages growing out of broken leases" (R. 146).[9]

Congress may also have had in mind the vital difference in substance between landlords, on the one hand, and most other classes of creditors, on the other. The landlords get their properties back, together with the right to all future appreciation in value over what may be a long term; yet they seek damages in addition. The merchandise creditor and the bondholder normally present the largest class of other creditors. They have parted with their property or money, as the case may be, and get nothing back but their claim.[10]

The claimants argue that *Northern Pacific Ry. Co.* v. *Boyd,* 228 U. S. 482, and similar cases (such as *Howard*

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[9]Would it not require the gift of prophecy to foresee that rental losses would exceed 50% over six years or 25% over twelve? See *Leo* v. *Pearce Stores Co.,* (D. Mich.) 57 F. [2d] 340, for a review of an actual trial of such a case. See also Judge Patterson's opinion in *In re Wise Shoes, Inc.,* 2 Fed. Supp. 521, aff'd *per curiam* (C. C. A. 2) 64 F. [2d] 1023.

[10]These considerations have previously been submitted to this Court (to quote from p. 332 of the opinion in the *Manhattan Properties* case):

> "The respondent asserts a substantial difference between rent and other kinds of indebtedness, and presents equitable considerations thought to weigh in its favor * * *."

v. *Maxwell Motor Co.* in the Second Circuit, 269 Fed. 292, 275 Fed. 53), compel a conclusion in their favor. It was there held that a court of chancery would not permit stockholders to share in a reorganization which did not make fair provision for any class of creditors, and that a creditor for whom such provision had not been made in the plan could follow the assets in the hands of the purchaser at the foreclosure sale. In applying this "fixed principle" referred to in the *Boyd* case this Court has encouraged "reasonable" and "practical" adjustments of the several rights of creditors and stockholders "measured by the existing circumstances" (See *Kansas City Terminal Railway* v. *Central Union Trust Co.*, 271 U. S. 445, 455).

While the chancery cases are without binding effect as to the power of Congress, they do indicate the Courts' opinion of what is or is not fair in dealing with this kind of problem. As in the case of equity reorganizations, the prime purpose of § 77B is to provide a basis, fair to creditors and stockholders alike, for continuing the enterprise without dismemberment or liquidation. Indeed, the acceleration of the claim of a holder of an "indemnity clause", accompanied by the three-year limitation, may well be said to constitute on the part of Congress a "fair offer" to creditors within the meaning of the decisions of this Court on the subject of equity reorganizations. *Cf. Kansas City Terminal Railway* v. *Central Union Trust Co.*, 271 U. S. 445, 454.

But, however that may be, "when a statutory system is administered, the only question for the Courts is what the statute prescribes", *Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597, unless the statute is clearly unfair, arbitrary or capricious.

Legislative limitation of amounts recoverable for injury is a commonplace.

The question was before this Court in the *Workmen's Compensation* cases. In *New York Central R. R. Co.* v. *White,* 243 U. S. 188, the New York act was considered. Because a new and workable, though rigid, amount of recovery was substituted for the indeterminate damages hypothetically recoverable in a negligence action, it was urged upon this Court

> "That the employee's rights are interfered with, in that he is prevented from having compensation for injuries arising from the employer's fault commensurate with the damages actually sustained, and is limited to the measure of compensation prescribed by the Act" (at p. 196).

In rejecting the argument, this Court concluded that there was no valid objection to a statutory limitation of amounts recoverable on the ground that sums in excess of those amounts *might* be recovered at common law:

> "* * * Nor can it be deemed arbitrary and unreasonable, from the standpoint of the employee's interest, to supplant a system under which he assumed the entire risk of injury in ordinary cases, and in others had a right to recover an amount more or less speculative upon proving facts of negligence that often were difficult to prove, and substitute a system under which in all ordinary cases of accidental injury he is sure of a definite and easily ascertained compensation, not being obliged to assume the entire loss in any case but in all cases assuming any loss beyond the prescribed scale" (at p. 204).

In that case the setting of legislative maxima of recovery was directly questioned. Yet there have been other

familiar examples, where the legislative power of limitation passed unchallenged. The various statutes derived from Lord Campbell's Act allow recovery for death by wrongful act. In some of these the recovery has been limited to $5,000. In others it is cut off at $10,000. So far from being questioned on constitutional grounds, the standard set in these acts has been referred to by Federal courts as an aid to fixing the damages for death in jurisdictions having no limitation. *Cheatham* v. *Red River Line,* 56 Fed. 248; *The Oceanic,* 61 Fed. 338; *Farmers' Loan & Trust Co.* v. *Toledo etc. Ry. Co.,* 67 Fed. 73.

Again, the original Federal statute limiting liability of ship owners provided that liability should not exceed the interest of the owner in the ship and her freight (L. 1851, ch. 43; 9 Stat. 635; see 46 U. S. C. 183). This limitation was repeatedly enforced by this Court. *Norwich Company* v. *Wright,* 13 Wall. 104; *Providence & New York Steamship Co.* v. *Hill Mfg. Co.,* 109 U. S. 578; *Butler* v. *Boston Steamship Co.,* 130 U. S. 527.

Petitioners' brief (at p. 46) cites an instance in which the courts have held invalid an *unreasonable* restriction upon amounts recoverable. The Pennsylvania statute in question limited the amount to be recovered in certain personal injury suits to $3,000. In *Kay* v. *Pa. R. R. Co.,* 65 Pa. St. 269, this provision was declared inoperative, since retrospective, where suit was brought before its passage. In the second case, *Passenger Railway Co.* v. *Boudrou,* 92 Pa. St. 475, a jury had rendered a verdict for $10,000 against the railroad. The lower court's disregard of the limitation was upheld, two judges dissenting. On the ground that the plaintiff's remedy at common law for personal injury could not be thus summarily curtailed, the prevailing opinion said:

> "The people have withheld power from the legislature and the courts to deprive them of that remedy, or to circumscribe it so that a jury can only give a pitiful fraction of the damage sustained" (at p. 482).

Cf. New York Central R. R. Co. v. *White, supra,* 243 U. S. 188.

Monongahela Navigation Co, v. *United States,* 148 U. S. 312, also stands for an entirely different principle, in that there an entire item of loss (loss of franchise value) had been arbitrarily rejected by Congress in providing for recovery under exercise of the powers of eminent domain.

The case of *East Kingston* v. *Towle,* 48 N. H. 57, also cited at page 45 of the petitioners' brief, decided only that a defendant could not be made liable for damages assessed in an *ex parte* non-judicial proceeding to which he was not a party.

Petitioners' cases throw into relief the validity of a reasonably conceived substitute for a plaintiff's former remedy, especially where the former remedy was admittedly inadequate as a practical matter, as was the plight of landlords with bankrupt corporate tenants.

Congress has provided a fair equivalent so that there may be a final determination of an otherwise contingent and speculative claim.

(C)

Application of these Principles and Authorities to the Facts of this Case.

Under the terms of the claimants' lease neither the amount, nor indeed the existence, of their loss will become

certain until late in the term,—perhaps even at its end (March 31, 1946). *Hermitage* v. *Levine,* 248 N. Y. 333. The covenant here was not to pay liquidated damages in the event of bankruptcy (*cf. Wm. Filene's Sons Co.* v. *Weed,* 245 U. S. 597, and *Irving Trust Co.* v. *Perry Co.,* 293 U. S. 307), but only to indemnify the claimants for any loss suffered during the term (R. 58). The Circuit Court of Appeals has stated, in *In re Outfitters' Operating Realty Co.,* 69 Fed. [2d] 90, 91, that such a covenant "requires the lessor to wait until the end of the term", the covenant *not* being, as this Court has expressly held (*Manhattan Properties, Inc.* v. *Irving Trust Co., supra,* at p. 338):

> "the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future."[11]

The claimants make light of the difficulty of presently evaluating the loss which may accrue to them in 1946 and

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[11]In an endeavor to raise the constitutional issue more acutely, the petitioners have framed their proof of claim as if their lease contained such a damage clause (R. 6-7). In *Miller* v. *Irving Trust Co.,* 296 U. S. 256, this Court had the following to say of another landlord who tried to improve his position in the same fashion:

> "The petitioner's statement of claim does not follow the covenant in his lease. It is made as if it rested on a covenant providing for damages equal to rents reserved less rental value for the rest of the terms, such as that on which the landlord prevailed in *Irving Trust Co.* v. *Perry Co.,* 293 U. S. 307. But petitioner's claim must be adjudged on the basis of the covenant that in his interest was inserted in the lease * * *."

completely ignore the possibility that in the end there may be no net loss at all. But it is this latter element of contingency which is the more serious. As Judge Learned Hand said for the Circuit Court of Appeals, in *In re Outfitters' Operating Realty Co., supra,* 69 F. [2d] at page 91:

> "It is the uncertainty in fact of the loss that invalidates the claim * * *."

CONCLUSION

It is respectfully submitted that the judgment of the Circuit Court of Appeals should be affirmed.

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DEC 12 19
CHARLES ELMORE

Supreme Court of the United States

October Term, 1936.

No. 354

IN THE MATTER

OF

UNITED CIGAR STORES COMPANY OF AMERICA,
Debtor.

CAROLINE R. KUEHNER and FREDERICK G. FISCHER, as Trustees,
Petitioners,

against

GRAYSON M.-P. MURPHY, et al., as a Preferred Stockholders Protective Committee, et al.,
Respondents.

On Writ of Certiorari to the Circuit Court of Appeals for the Second Circuit.

BRIEF FOR RESPONDENT PREFERRED STOCKHOLDERS PROTECTIVE COMMITTEE

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STATUTES CITED

Bankruptcy Act, Sec. 77-B	2, 3, 5, 7
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Opinions Below.

The opinion of the District Court appears at page 146 of the record and is not officially reported. The opinion of the Circuit Court of Appeals is reported at 85 F. (2d) 35.